

## Nagarjuna Construction

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,787	NJCC IN
	REUTERS CODE
S&P CNX: 3,185	NGCN.BO

**30 May 2006**
**Buy**
*Previous Recommendation: Buy*
**Rs355**

Equity Shares (m)	103.0
52-Week Range	404/146
1,6,12 Rel. Perf. (%)	3/23/67
M.Cap. (Rs b)	36.5
M.Cap. (US\$ b)	0.8

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	18,404	1,039	10.1	34.8	35.2	3.8	16.3	15.2	1.9	21.0
3/07E	29,450	1,965	19.1	89.2	18.6	3.3	19.1	18.6	1.3	13.9
3/08E	47,600	3,077	29.9	56.6	11.9	2.7	25.0	21.7	0.9	9.5

**Financial performance:** During FY06, NCC reported revenues of Rs18.4b (up 55% YoY), EBITDA of Rs1.6b (up 81% YoY) and net profit of Rs1.04b (up 74.6% YoY). EBITDA margins expanded to 8.9% during FY06 (v/s 7.6% in FY05) driven by operating leverage, change in revenue composition and higher equipment purchases. Net profit margin improved to 5.6% in FY06 (up 64bp YoY). Order backlog was up 51.1% YoY to Rs54.3b as at March 2006.

### Management guidance

- Revenues Rs30b in FY07 v/s Rs18.4b in FY06 (up 63% YoY)
- Order intake of Rs43b in FY07 v/s Rs36b in FY06 (up 19% YoY)
- Order backlog of Rs68b-70b in March 2007 v/s Rs54b in March 2006

**Key takeaways from the conference call:** (1) During FY07, NCC is working on two key initiatives in construction segment – international business and gas pipeline vertical (2) NCC's three BOT road projects to achieve financial closure by August 2006 (3) Increase in net worth to Rs9.4b in March 2006 v/s Rs3.2b in March 2005 has enhanced bidding capacity (4) Real estate revenues targeted at Rs1b in FY07 v/s Rs460m in FY06.

**Valuation and view:** We expect NCC to report net profit of Rs2b during FY07 (up 89.2% YoY), and Rs3.1b in FY08 (up 56.6% YoY). At CMP of Rs355, NCC (on reported basis) quotes at PER of 19x FY07E and 12x FY08E. Adjusting for cash, land bank and BOT projects, it quotes at PER of 12.5x FY07E and 8x FY08E. For FY06, NCC has declared dividend of 80% and proposed bonus shares in ratio of 1:1 Maintain **Buy**, with price target of Rs475/share.

Y/E MARCH	QUARTERLY PERFORMANCE									
	FY 05				FY 06				FY 05	FY 06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
<b>Sales</b>	2,324	2,418	2,642	4,500	3,594	3,682	4,724	6,404	11,885	18,404
Change (%)			37.8	54.3	54.6	52.3	78.8	42.3	56.8	54.9
<b>EBITDA</b>	172	194	219	322	278	379	457	531	907	1,640
Change (%)			42.7	45.0	61.3	95.3	108.9	65.2	54.4	80.8
As of % Sales	7.4	8.0	8.3	7.1	7.7	10.3	9.7	8.3	7.6	8.9
Depreciation	24	26	31	28	34	41	53	54	109	182
Interest	34	27	38	48	43	89	97	44	147	217
Other Income	5	9	12	23	13	15	17	5	49	20
<b>PBT</b>	121	150	162	268	214	264	324	439	700	1,262
Tax	19	36	41	31	22	55	56	90	127	223
Effective Tax Rate (%)	15.8	23.9	25.4	11.7	10.4	20.9	17.3	20.5	18.2	17.7
<b>Reported PAT</b>	102	114	121	236	192	209	268	349	573	1,039
<b>Adj PAT</b>	102	114	121	236	192	209	268	349	595	1,039
Change (%)			39.8	108.4	88.9	83.3	121.6	47.9	88.0	74.6

E: MOST Estimates

Satyam Agarwal (Agarwals@MotilalOswal.com); Tel: +91 2239825410 / Anjali Shah Vora (Anjali@MotilalOswal.com); Tel: +91 22 39825415

**Robust FY06 financial performance**

During FY06, NCC reported revenues of Rs18.4b (up 55% YoY), EBITDA of Rs1.6b (up 81% YoY) and net profit of Rs1.04b (up 74.6% YoY). EBITDA margins expanded to 8.9% during FY06 (v/s 7.6% in FY05), driven by operating leverage, change in revenue composition and higher equipment purchases. Net profit margin improved to 5.6% in FY06 (up 64bp YoY).

**Strong guidance for FY07**

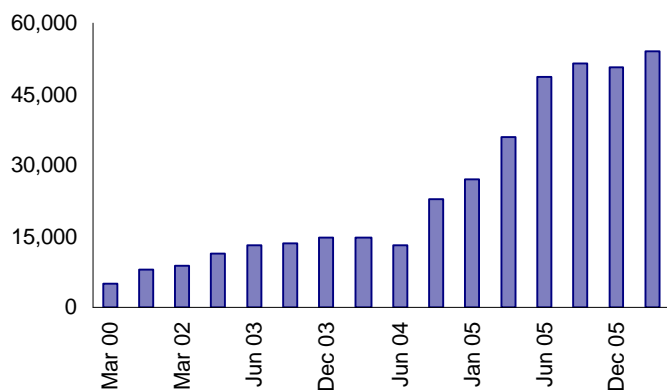
Management has provided guidance for:

- ⌘ Revenues Rs30b in FY07 v/s Rs18.4b in FY06 (up 63% YoY)
- ⌘ Order Intake of Rs43b in FY07 v/s Rs36b in FY06 (up 19% YoY)
- ⌘ Order backlog of Rs68b-70b in March 2007 v/s Rs54b in March 2006
- ⌘ EBITDA margin expansion in FY06 to sustain in FY07 and FY08

**Effective order book at Rs58b (3.2x FY06 revenues)**

Order backlog as at March 2006 was Rs54.3b, up 51.1% YoY. In addition, the company has emerged as the lowest cost bidder for projects worth Rs4b, resulting in an effective order book of Rs58b (equivalent to 3.2x FY06 revenues). During May 2006, the company has already announced projects worth Rs5b in April – May 2006.

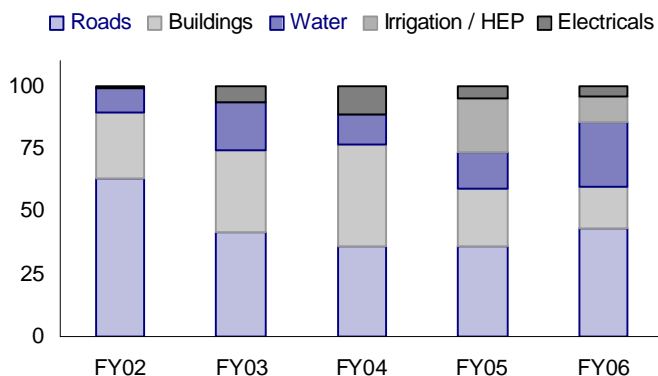
TREND IN ORDER BACKLOG (RS B)



Source: Company/ Motilal Oswal Securities

Share of roads in order backlog increased to 43% in FY06 v/s 36% in FY05, while the share of water segment increased to 26% in FY06 from 14% in FY05.

ORDER BOOK COMPOSITION (%)



Source: Company/ Motilal Oswal Securities

**Key takeaways from the conference call**

**Initiatives in core construction business**

- ⌘ **International business:** NCC is targeting to enhance presence in the international markets. Recently, the company bagged its first international project of Rs1.2b, from Muscat Municipality, for pipeline. It has established offices in Muscat and Dubai to focus on roads, buildings and water pipelines projects in Middle East and Asia.
- ⌘ **Gas pipelines segment:** NCC is expanding presence in gas pipeline vertical (onshore), and targeting 10% revenue contribution from this segment by FY08. The company has signed an MoU with Italian company for bidding for gas pipeline projects, and intends to take the joint venture route to bid for projects in India and other Asian countries.

**BOT projects**

NCC currently has a portfolio of 4 BOT road projects and emerged as the lowest cost bidder for 100MW hydro power project in Himachal Pradesh. Further, the company has submitted bids for two national highway projects in Andhra Pradesh, and is submitting bids for road projects in Uttar Pradesh and Punjab. The management intends to bag 2-3 road projects every year on BOT basis.

### Status of BOT projects

- ✍ Bangalore-Maddur Annuity Project (Rs2.5b, NCC's share - 33.3%) has been completed and will commence commercial operation in June 2006. Thus, consortium would be eligible for bonus of four months amounting to Rs297m, which will increase expected RoE to ~25% (vs 18% at the time of bidding).
- ✍ Meerut-Muzzafarpur Toll Project (project value Rs5b, NCC's share 50%) is expected to achieve financial closure in June 2006
- ✍ Bangalore Elevated Corridor Project (project value Rs7.65b, NCC's share 30%) is expected to achieve financial closure in July 2006
- ✍ Oral - Bhognipur (35kms) and Bhognipur - Barah (17.8kms) road projects on annuity basis (project value Rs5.2b, NCC's share 64%) expected to achieve financial closure in August 2006.
- ✍ Sorang HEP (100MW) in Himachal Pradesh (project cost of Rs5b, NCC's share 30%). The Detailed Feasibility Report is under preparation, and would be completed in next six months.

### Increase in net worth enhances bid capacity

After the recent GDR offering (US\$120m), NCC's net worth has increased to Rs9.4b in FY06 v/s Rs3.2b in FY05. This has increased the bidding capacity of the company significantly, and would now enable the company to bid for large projects independently. For instance, NHAI cash contracts stipulate that 'Average three years networth of all the consortium partners put together should be atleast 25% of the project cost'.

### Increased focus on real estate

During FY06, real estate division contributed Rs460m as revenues, up from Rs429m in FY05. The management expects this to increase to Rs1b in FY07. The management stated that EBITDA margins in this segment are ~20%, as it involves both construction and development profits.

- ✍ NCC has land bank of 130 acres spread across Bangalore, Mysore, Hyderabad, Kochi, Vizag and Chennai, which would be developed over next three years. The management stated that market value of this land bank is over Rs2b (purchase cost Rs240m),

thus resulting in potential capital gains of Rs1.76b.

- ✍ NCC is currently executing the National Games Village project spread across 55 acres in Ranchi, Jharkhand, which is scheduled for completion by end 2007 at a cost of Rs3b. The company has signed the development agreement with the Government. The project involves construction of 1,818 villas, which can be sold by the company post National games in 2007. The government will provide land in lieu of 12% of the developed area (212 villas).
- ✍ NCC has also entered into a development agreement for 85 acres of land at Vizag, with the Andhra Pradesh Housing Board. The land is transferred at Rs9.2m per acre. As per the development agreement, 75% of the area would be used for construction of residential houses and 25% for commercial purpose. NCC has 89% stake in the venture, while Uppal Housing has 11%.
- ✍ Recently, NCC (25%) in consortium with ICICI Venture Funds (60%) and Maytas Infrastructures (15%) has acquired six acre plot in Jubilee Hills, Hyderabad for Rs3.4b. Development plans include construction of five star hotel, retail mall and commercial complex at cost of Rs8b.

### Capex

During FY06, the company incurred a capex of Rs930m, which is expected to increase to Rs1.5b in FY07. This is largely towards procurement of plant and machinery.

### Utilization of GDR funds

During January 2006, NCC raised Rs5.5b through of GDRs. As at end March 2006, the company had invested Rs4.5b as, real estate projects Rs1.5b, working capital Rs2b, BOT projects Rs800m, and capex Rs200m.

### Valuation and view

We expect NCC to report net profit of Rs2b during FY07 (up 89.2% YoY), and Rs3.1b in FY08 (up 56.6% YoY). Based on our SOTP valuations, we arrive at a target price of Rs475/share. We have valued the core business at Rs359/share (12x P/E FY08), BOT portfolio at Rs51/share, real estate projects at Rs22/share and investments at Rs43/share.

## Nagarjuna Construction: an investment profile

### Background

Nagarjuna Construction Company is a Hyderabad-based construction company, and has its origins from the partnership business Nagarjuna Construction Corporation established in 1978. It is promoted by Mr. A.V.S. Raju. The company has a fairly diversified business mix with a presence across roads, buildings, water, irrigation, hydro power etc.

### Key investment arguments

- Effective current order book (including L1 projects and cash EPC contracts from own BOT portfolio) stands at Rs58b, 3.2x FY06 revenues
- Post fund raising, NCC has net worth of Rs9.4b in March 2006 (v/s Rs3.2b in March 2005) enabling it to bid for bigger ticket sized projects and also build a BOT portfolio
- NCC is focusing on several new verticals like gas pipelines, real estate development etc.

### Key investment risks

- BOT projects depress initial RoE.
- Retention of experienced personnel is a challenge.
- Infrastructure capex is highly cyclical and dependent on government policies.

### Recent developments

- Has recommended 80% dividend for FY06.
- Board of directors proposed bonus shares in ratio of 1:1.

### Valuations and view

- Based on SOTP methodology, we arrive at our PT to Rs475/share.
- At CMP of Rs355, NCC (on reported basis) quotes at PER of 19x FY07E and 12x FY08E. Adjusting for cash, land bank and BOT projects, it quotes at PER of 12.5x FY07E and 8x FY08E.

### Sector view

- Increased government commitment towards infrastructure projects has led to several large projects taking off the ground.
- We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage.
- BOT ventures could unlock sizable value.

#### COMPARATIVE VALUATIONS

		NCC	HCC	IVRCL
P/E (x)	FY07E	19.0	19.8	19.7
	FY08E	12.0	15.1	13.6
P/E adj (x)*	FY07E	12.5	11.9	10.1
	FY08E	8.0	9.0	7.0
P/BV (x)	FY07E	3.3	2.6	3.2
	FY08E	2.7	2.3	2.7
RoE (%)	FY07E	19.1	16.8	17.6
	FY08E	25.0	16.3	21.6

\*adjusted for BoT and other investments

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	25.7	26.7	34.1
Domestic Institutions	8.6	7.7	7.6
FII's/FDIs	30.2	25.6	3.7
Others	35.5	40.0	54.6

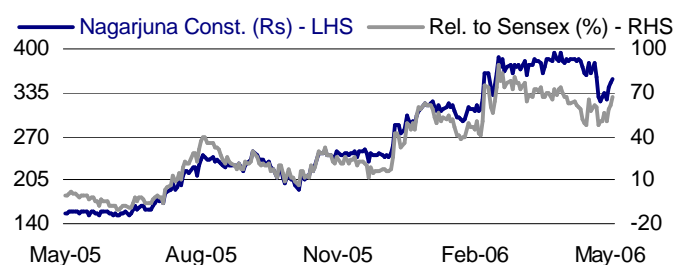
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	19.1	19.0	0.5
FY08	29.9	26.3	13.7

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
355	475	33.8	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Net Sales</b>	<b>7,582</b>	<b>11,885</b>	<b>18,404</b>	<b>29,450</b>	<b>47,600</b>	
Change (%)	67.1	56.8	54.9	60.0	61.6	
Construction Expenses	6,606	10,407	14,026	25,453	41,045	
Staff Cost	200	309	2,251	894	1,520	
Office and Site Establish. Exps	188	262	487	334	400	
<b>EBITDA</b>	<b>588</b>	<b>907</b>	<b>1,640</b>	<b>2,768</b>	<b>4,635</b>	
% of Net Sales	7.7	7.6	8.9	9.4	9.7	
Depreciation	91	109	182	239	320	
Interest	134	147	217	393	677	
Other Income	41	49	20	320	209	
<b>PBT</b>	<b>404</b>	<b>700</b>	<b>1,262</b>	<b>2,456</b>	<b>3,846</b>	
Tax	88	127	223	491	769	
Rate (%)	21.8	18.2	17.7	20.0	20.0	
<b>Reported PAT</b>	<b>316</b>	<b>573</b>	<b>1,039</b>	<b>1,965</b>	<b>3,077</b>	
Extra-ordinary Expenses	1	22	0	0	0	
<b>Adjusted PAT</b>	<b>316</b>	<b>595</b>	<b>1,039</b>	<b>1,965</b>	<b>3,077</b>	
Change (%)	71.5	88.0	74.6	89.2	56.6	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Share Capital	115	159	206	206	206	
Reserves	1,507	3,087	9,365	10,919	13,351	
<b>Net Worth</b>	<b>1,621</b>	<b>3,255</b>	<b>9,571</b>	<b>11,125</b>	<b>13,557</b>	
Loans	1,540	2,648	3,878	5,936	10,991	
Deferred Tax Liability	43	66	66	66	66	
<b>Capital Employed</b>	<b>3,205</b>	<b>5,969</b>	<b>13,515</b>	<b>17,128</b>	<b>24,614</b>	
Gross Fixed Assets	1,414	1,665	2,674	3,574	4,774	
Less: Depreciation	507	576	756	995	1,315	
<b>Net Fixed Assets</b>	<b>907</b>	<b>1,089</b>	<b>1,919</b>	<b>2,579</b>	<b>3,460</b>	
Capital WIP	12	9	0	0	0	
Investments	5	462	462	2,462	4,462	
<b>Curr. Assets</b>	<b>4,306</b>	<b>7,462</b>	<b>14,890</b>	<b>18,184</b>	<b>25,930</b>	
Inventory	1,019	1,523	2,420	3,873	6,260	
Debtors	843	1,916	2,420	3,873	6,260	
Cash & Bank Balance	657	1,372	5,994	4,043	3,608	
Loans & Advances	1,770	2,629	4,034	6,374	9,781	
Other Current Assets	17	21	21	21	21	
<b>Current Liab. &amp; Prov.</b>	<b>2,028</b>	<b>3,087</b>	<b>3,790</b>	<b>6,131</b>	<b>9,272</b>	
Creditors	1,312	2,160	2,690	4,881	7,872	
Other Liabilities	525	621	700	700	700	
Provisions	192	305	400	550	700	
<b>Net Current Assets</b>	<b>2,278</b>	<b>4,375</b>	<b>11,100</b>	<b>12,053</b>	<b>16,658</b>	
Misc. Expenses	3	34	34	34	34	
<b>Application of Funds</b>	<b>3,205</b>	<b>5,969</b>	<b>13,515</b>	<b>17,128</b>	<b>24,614</b>	

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Basic (Rs)</b>						
<b>Adjusted EPS</b>	<b>5.5</b>	<b>7.5</b>	<b>10.1</b>	<b>19.1</b>	<b>29.9</b>	
Growth (%)	41.6	35.4	34.8	89.2	56.6	
Cash EPS	7.1	8.9	11.8	21.4	33.0	
Book Value	28.4	40.5	92.6	107.7	131.3	
DPS	0.8	1.2	1.6	3.5	5.5	
Payout (incl. Div. Tax.)	16.3	18.8	18.1	20.9	21.0	
<b>Valuation</b>						
P/E (standalone)		47.4	35.2	18.6	11.9	
Cash P/E		40.1	29.9	16.6	10.8	
EV/EBITDA		41.7	21.0	13.9	9.5	
EV/Sales		3.2	1.9	1.3	0.9	
Price/Book Value		8.8	3.8	3.3	2.7	
Dividend Yield (%)		0.3	0.5	1.0	1.6	
<b>Profitability Ratios (%)</b>						
RoE	23.4	24.5	16.3	19.1	25.0	
RoCE	20.2	18.5	15.2	18.6	21.7	
<b>Turnover Ratios</b>						
Debtors (Days)	41	59	48	48	48	
Inventory (Days)	49	47	48	48	48	
Creditors. (Days)	72	76	70	70	70	
Asset Turnover (x)	2.8	2.6	1.9	1.9	2.3	
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.9	0.8	0.4	0.5	0.8	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
PBT before Extraordinary Items	<b>404</b>	<b>700</b>	<b>1,262</b>	<b>2,456</b>	<b>3,846</b>	
Add : Depreciation	91	109	182	239	320	
Interest	134	147	217	393	677	
Less : Direct Taxes Paid	88	127	223	491	769	
(Inc)/Dec in WC	-646	-1,376	-2,103	-2,904	-5,040	
<b>CF from Operations</b>	<b>-105</b>	<b>-547</b>	<b>-666</b>	<b>-307</b>	<b>-966</b>	
(Inc)/Dec in FA	-176	-287	-1,002	-900	-1,200	
(Pur)/Sale of Investments	1	-458	0	-2,000	-2,000	
<b>CF from Investments</b>	<b>-176</b>	<b>-745</b>	<b>-1,002</b>	<b>-2,900</b>	<b>-3,200</b>	
(Inc)/Dec in Network	291	1,154	5,466	0	0	
(Inc)/Dec in Debt	533	1,108	1,230	2,059	5,054	
Less : Interest Paid	134	147	217	393	677	
Dividend Paid	52	108	188	411	646	
<b>CF from Fin. Activity</b>	<b>639</b>	<b>2,007</b>	<b>6,290</b>	<b>1,255</b>	<b>3,731</b>	
<b>Inc/Dec of Cash</b>	<b>358</b>	<b>715</b>	<b>4,622</b>	<b>-1,951</b>	<b>-435</b>	
Add: Beginning Balance	299	657	1,372	5,994	4,043	
<b>Closing Balance</b>	<b>657</b>	<b>1,372</b>	<b>5,994</b>	<b>4,043</b>	<b>3,608</b>	



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

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**Nagarjuna Construction**

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|----------------------------------------------|----|
| 1. Analyst ownership of the stock            | No |
| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

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